NO. 80359-5

WASHINGTON STATE SUPREME COURT

CERTIFICATION FROM
THE UNITED STATES DISTRICT COURT,
FOR THE WESTERN DISTRICT OF WASHINGTON

IN

ST. PAUL FIRE AND MARINE INSURANCE COMPANY,

Plaintiff,

vs.

ONVIA, INC., ONVIA.COM, and RESPONSIVE MANAGEMENT SYSTEMS, in its individual capacity and as class representative of a purported settlement class,

Defendants.

Appellee-Defendant Responsive Management Systems' Opposition to Brief of *Amici Curiae*

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

INTRODUCTION

Washington law recognizes a separate and independent cause of action for bad faith that sounds in tort. Washington's common law tort claim for bad faith is not, as Amici argues, derivative or dependent on a breach of contract claim. Accordingly, an insured may maintain an action against its insurer for bad faith claims handling irrespective of whether the insurer was ultimately correct in determining coverage did not exist.

Further, for sound public policy reasons, this Court long ago adopted a rebuttable presumption of harm which to shifts the burden of proof on the element of harm to the insurer upon proof of the insurers' bad faith conduct. When bad faith is found, Washington courts apply the estoppel remedy to determine the measure of damages in third party liability bad faith cases. Based on preexisting law and sound public policy, the Court should apply both the rebuttable presumption of harm and the estoppel remedy in this case.

ARGUMENT

A. This Court Recognizes a Separate and Independent Cause of Action for Bad Faith Sounding in Tort in a Third Party Liability Case in the Absence of Coverage.

The Amici[1] are some of the largest trade associations of major property and casualty insurers. On behalf of its members, including plaintiff-appellant St. Paul,[2] Amici ask this Court to reverse over a decade of Washington state case law and Washington Supreme Court precedent requiring insurers to act reasonably in their claims handling actions and omissions throughout the life of a claim. This includes, without limitation, the insurers' acknowledgement of notice and tender; timely claim investigation and correspondence with the insured regarding the claim; and timely communication of the insurers' coverage determination. Instead of the Washington standard of reasonableness, Amici attempt to persuade this Court to immunize all insurers in

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[1] The Amici include the American Insurance Association; the Complex Insurance Claims Litigation Association; the National Association of Mutual Insurance Companies; and the Property and Casualty Insurers Association of America.

[2] Amici did not list their membership in their Statement of Interest and Representation. In footnote 1 of their brief, Amici disclaims that their brief is filed on behalf of Travelers, an "affiliate" of St. Paul. Amici Br., p. 1 n1. St. Paul is not excluded. It appears, therefore, that, in fact, the Amici brief is filed on behalf of their member St. Paul, and that the brief was not filed solely out of an abstract trade association interest.

Washington from liability for acting unreasonably based upon an after the fact legal determination that no coverage exists. Onvia asks this the Court to reject Amici's position.

The record indicates that St. Paul allegedly failed to respond to Onvia's notice and tender of the underlying complaint for eight months. There is no question that if St. Paul cannot rebut this allegation, this conduct breached St. Paul's duty to handle Onvia's insurance claim in good faith.[3] It is also undisputed that there is a separate, free standing cause of action for bad faith in Washington that sounds in tort. *Safeco Insurance Co. v. Butler*, 118 Wn.2d 383, 389, 823 P.2d 499 (1992).[4] *See* Response Br. of Def. Responsive Management Systems (Response Br.), pp. 11–16.

Amici's argument that the separate bad faith claim sounding in tort "should not exist completely independently of the insurer's contractual

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[3] "Based on the violation of the Consumer Protection Act, WAC, 284-30-330 (13), and Truck Insurance's unconscionable delay in responding to its insured, we affirm the finding of bad faith." *Truck Insurance Exchange v. Vanport Homes, Inc.,* 147 Wn.2d 751, 764, 58 P.3d 276 (2002).

[4] Amici fundamentally mischaracterizes this Court's ruling in *Bulter*, 118 Wn.2d at 394. When stating that the bad faith remedy must take into account "all aspects of the insurer/insured relationship," the *Butler* court was explaining why the bad faith cause of action and remedy cannot be limited to those available for breach of contract.

obligations"[5] finds no support in Washington law. To the contrary, in fact, this Court stated that such a claim exists in *Coventry Associates v. American States Ins. Co.*, 136 Wn.2d 269, 279, 961 P.2d 933 (1998):

> An insured may maintain an action against its insurer for bad faith investigation of the insured's claim and violation of the CPA regardless of whether the insurer was ultimately correct in determining coverage did not exist.

Amici argues that the *Coventry* Court's reference to a claim for "bad faith investigation" is limited to a claim for breach of the insurers' obligation to investigate found in the insurance policy. This argument is misplaced. As the *Coventry* Court explained, the insurers' failure to investigate gave rise to an *extra*-contractual claim for bad faith, not a claim for breach of the contractual obligation to investigate. *See* 136 Wn.2d at 279 (quoted *supra*).

In *Fireman's Fund Insurance Cos. v. Alaskan Pride Partnership*, 106 F.3d 1465, 1470 (9th Cir. 1997), the Ninth Circuit upheld the separate bad faith cause of action sounding in tort under Washington law for failing to conduct a reasonable investigation. The court specifically rejected the insurer's jury instruction on breach of the duty to investigate because it

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[5] Brief of *Amici Curiae* (Amici Br.) p. 4.

was based on the contractual policy language rather than the duty to investigate arising under the Washington Claims Handling Regulations.

While *Coventry* addressed the bad faith cause of action in the context of first, rather than third party coverage, both Division 1 and Division 2 of the Washington Court of Appeals have reiterated this Washington rule in third party liability bad faith cases. *Stouffer & Knight v. Continental Casualty Co.*, 96 Wn. App. 741, 755, 982 P.2d 105 (1999)[6]; *Torina Fine Homes, Inc. v. Mutual of Enumclaw Insurance Co.*, 118 Wn. App. 12, 20, 74 P.3d 648 (2003).

Amici's willful ignorance of the extra-contractual obligation of insurers to handle claims in good faith under Washington law is demonstrated by Amici's statement that "the insurer lived up to its obligations to the policyholder, which turned out to be non-existent."[7] Indeed, Amici's entire argument ignores the separate and independent duty of insurers to handle every claim tendered for defense and indemnification in a reasonable manner and in compliance with the Washington Claims Handling Regulations. St. Paul's alleged conduct in

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[6] Amici's attempt to distinguish *Stouffer*, 118 Wn. App. at 20, misrepresents the facts in that case. The insured's bad faith investigation claim failed because the insurer paid the insured's chosen attorney to conduct the investigation and the insured was satisfied with the investigation performed by the attorney.

[7] Amici Br., p. 9.

failing to respond to the insured's tender for over eight months was unreasonable and, therefore, in bad faith and in violation of the Washington regulations.

Like St. Paul, Amici argues that this Court should undo years of Washington Supreme Court precedent developed to protect Washington insureds from bad faith conduct exactly like St. Paul's unreasonable conduct alleged in this case. *See* Response Br., pp. 16–23. One insurer's attempt to avoid liability for its alleged unreasonable, bad faith conduct should not be the basis for this Court to strip Washington insureds of the protections this Court has carefully put in place over the past almost 20 years.

Amici also raises the specter of floodgates bursting open to waves of frivolous insurance claims as insureds attempt to entrap unsuspecting insurers in unreasonable claims handling practices.[8] This is nonsense. The bad faith cause of action at issue here already exists under Washington law. *See* Response Br., pp. 4–11. Further, and more specifically, on December 6, 2007, the Insurance Fair Conduct Act, RCW 48.30.010-015, took effect.[9] The new Act codifies the existing common

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[8] Amici Br., pp. 2, 12.

[9] RMS takes no position on whether the Insurance Fair Conduct Act, RCW 48.30.010-015, applies retroactively.

law cause of action for bad faith in third party liability cases in the absence of coverage. *Id.* St. Paul's warning cry rings hollow in light of the Legislature's affirmation of RMS' position that the tort of bad faith exists extra-contractually.

In conclusion, Amici has not raised any issues this Court has not considered and rejected each and every time this Court has decided a bad faith case in the last sixteen years since *Butler*, 118 Wn.2d 383. Washington law recognizes a separate and independent common law claim for bad faith claims handling that sounds in tort despite a finding of no coverage under the policy. This bad faith claim stands alone. It is not derivative of a breach of contract claim or dependent on a finding that the insurer breached the insurance policy by failing to provide coverage. There is simply no Washington precedent for the proposition that a finding of coverage is required before an insurer may be held liable in common law for its unreasonable claims handling conduct.

B. Washington's Rebuttable Presumption of Harm in Third Party Bad Faith Cases Appropriately Shifts the Burden to Prove Harm to the Insurer.

This Court applies a rebuttable presumption of harm to shift the burden of proof on the tort element of harm upon proof of the insurer's bad faith conduct. The Court has not wavered from this approach since announcing the presumption in 1992 in *Bulter*, 118 Wn.2d 383. Amici

now ask this Court to carve out an exception for cases in which the insured's bad faith conduct resulted from unreasonable claims handling rather than other unreasonable conduct such as the unreasonable denial of coverage, the unreasonable refusal to defend, the unreasonable failure to settle within limits, or the unreasonable injection of coverage issues into the underlying defense action. The line Amici attempts to draw is a distinction without a difference because all types of bad faith are, nonetheless, bad faith. *Besel v. Viking Insurance Co. of Wisconsin*, 146 Wn.2d 730, 737, 49 P.3d 887 (2002).

As a threshold matter, Amici misunderstands how the rebuttable presumption has been applied in Washington. The presumption simply serves to shift the burden of proof on the element of harm to the insurer. *Butler,* 118 Wn.2d at 394. "The insurer can rebut the presumption by showing by a preponderance of the evidence its acts did not harm or prejudice the insured." *Mutual of Enumclaw Insurance Co. v. Dan Paulson Construction, Inc.*, 161 Wn.2d 903, 920, 169 P.3d 1 (2007) (quoting *Butler*, 118 Wn.2d at 394). Therefore, once the insured proves the insurer has breached its duty to act in good faith, the burden of proving harm shifts to the *insurer* to prove that the insured was *not* harmed by the insurer's bad faith conduct. If the insurer meets its burden of proof to show that there was no harm, then the burden shifts back to the insured to

prove that it actually suffered harm. Hence the presumption is a rebuttable one.

Amici is simply wrong that the presumption allows an insured to recover for the insurer's bad faith conduct without suffering harm resulting from the bad faith. The insured has the ultimate burden of proof under a rebuttable presumption. If the insurer believes that the insured has not suffered harm as a result of the insurer's unreasonable conduct, then the insurer has a full opportunity to present that evidence to the trier of fact and if successful, may shift the burden back to the insured. This Court should not be persuaded to abandon its long-standing application of a rebuttable presumption of harm by the Amici's misunderstanding of how a rebuttable presumption would work in this case.

In *Paulson*, for example, which is this Court's most recent decision concerning third party bad faith claims, the Court succinctly explained the public policy supporting a rebuttable presumption upon a showing of insurer bad faith:

> With the *Butler* presumption of harm, this court announced a policy choice to protect third-party insureds and dissuade insurer bad faith. In the more than 15 years that have elapsed since *Butler*, the legislature has not altered the *Butler* presumption, nor has this court retreated from it.

Paulson, 161 Wn.2d at 921.

Ignoring the procedural posture of this case, Amici argues against the rebuttable presumption on the ground that RMS cannot prove that it suffered harm as a matter of law. This is wholly inappropriate, given that the Court has not determined which party has the initial burden on the proof of harm and neither party has had an opportunity to present evidence in the trial court. It is improper for Amici to assume facts that the trial court has not yet had an opportunity to adjudicate. Further, this Court specifically rejected the insurers' argument that the insured could not prove harm as a matter of law in *Paulson*, 161 Wn.2d at 922. The *Paulson* Court found that the decision to proceed with the arbitration, despite the insurer's interference in the underlying action by subpoenaing the arbitrator on the eve of the hearing, did not preclude a finding of harm.

As explained at length in RMS' Response Brief, pp. 23-28, the Court shifts the burden to prove harm to the insurer because proof of what would have happened had the insurer not breached its duty of good faith rightfully belongs to the insurer that breached the duty. *Kirk v. Mount Airy Insurance Co.*, 134 Wn.2d 558, 563, 951 P.2d 1124 (1998) (quoting *Butler*, 118 Wn.2d at 390). The rebuttable presumption of harm is applied for two reasons. First, the insurer has the power to avoid breaching the duty of good faith in the first place. *Besel*, 146 Wn.2d at 740 ("[I]t was within Viking's power to limit its liability by acting in good faith"); *Paulson*, 161 Wn.2d at 921 ("As between the insured and the insurer, it is the insurer that controls whether it acts in good faith or bad.")

Second, as explained by this Court in *Kirk*, unless the burden is shifted, the insurer could avoid liability for its bad faith under the same contract theory that St. Paul and Amici offer here: "our bad faith breach did not cause injury to the insured because ultimate liability was found to be outside the scope of coverage." *Kirk*, 134 Wn.2d at 563. In fact, Amici makes the same argument here that this Court soundly rejected from the insurance industry Amicus in *Kirk* ten years ago:

> Amicus argues if a jury or court find that liability rests outside the scope of coverage, any bad faith on the part of the insurer did not cause harm and the insurer cannot be found liable. *This argument misses the point.*

Id. (emphasis added.)

The "point" according to the Supreme Court was that the insured had not received the benefit of the bargain because the insurer breached its duty of good faith. *Id.* The same point applies here.

This Court should reject Amici's tired and outdated argument here for the same reason it did so in *Kirk*: if RMS shows that St. Paul failed to respond to Onvia's tender of the underlying claim for over eight months, there is no dispute that such conduct was unreasonable and, therefore, in bad faith. By acting in bad faith, St. Paul prevented its insured from receiving the benefit of the bargain and violated the Washington Claims Handling Regulations. By ensuring a bad faith cause of action and shifting the burden of proof, the Court "creates a strong incentive for the

insurer to act in good faith, and protects the insured against the insurer's bad faith conduct." *Kirk,* 134 Wn.2d at 564 (citing *Butler*, 118 Wn.2d at 394).

In response, Amici argues the rebuttable presumption of harm applies only where the insurer's bad faith conduct involves the "conflicts of interest" inherent in a reservation of rights defense.[10] This too is an old argument rejected by this Court years ago. In *Butler*, 118 Wn.2d at 391, this Court stated that "we presume prejudice in any case in which the insurer acted in bad faith." This Court also applied the rebuttable presumption of harm in *Besel*, 146 Wn.2d at 737.[11] In doing so, this Court stated categorically that application of the rebuttable presumption of harm "do[es] not depend on *how* an insurer acted in bad faith. Rather, the principles apply *whenever* an insurer acts in bad faith...." *Id.* at 737 (emphasis added). The *Besel* Court went on to list the three main circumstances in which an insurer could commit bad faith, to further underscore that the rebuttable presumption of harm applies in *all* types of third party bad faith cases without limitation:

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[10] Amici Br., p. 14-15.

[11] While *Besel* involved bad faith failure to settle, rather than a bad faith conduct of a reservation of rights defense, these facts are not distinguishable.

(a) Poorly defending a claim under a reservation of rights (referencing *Butler* as an example);

(b) Refusing to defend a claim (referencing *Kirk* as an example); or

(c) Failing to properly investigate a claim (referencing *Coventry* as an example).

Besel, 146 Wn.2d at 737.

While the first *Besel* category invokes the "conflicts of interest" referenced by Amici, the second two *Besel* categories do not. Neither St. Paul nor Amici can escape the obvious fact that this Court has applied the rebuttable presumption of harm at least twice when bad faith arising from a reservation of rights defense was *not* at issue. *Kirk*, 146 Wn.2d 730 (bad faith failure to defend at all); *Besel,* 146 Wn.2d at 737 (bad faith failure to settle).

The rebuttable presumption of harm applies in *all* third party liability bad faith cases. There is no reasoned basis for this Court to retreat from its existing practice of applying the rebuttable presumption of harm to shift the burden of proof to the insurer upon a showing of unreasonable bad faith claims handling. In the face of this Court's careful development of bad faith law as a means to protect against insurers' bad faith, Amici offers only the same tired and outdated arguments rejected by

this Court ten years ago. RMS respectfully suggests that this Court should apply the rebuttable presumption of harm in this case as it has in every other third party liability bad faith case that this Court has decided in the last sixteen years.

C. Washington's Long-Standing Estoppel Remedy Establishes the Measure of Damages Where The Element of Harm is Satisfied under the Rebuttable Presumption.

As this Court explained just months ago in *Paulson*, 161 Wn.2d at 924, the remedy for a successful bad faith claim in a third party liability action is estoppel to deny coverage. Under the estoppel remedy, "the amount of a covenant judgment is the presumptive measure of an insured's harm caused by an insurer's tortuous bad faith if the covenant judgment is reasonable." *Id.* (quoting *Besel*, 146 P.2d 738.)

Washington first adopted the estoppel remedy for insurer bad faith over fifty five years ago in *Evans v. Continental Casualty Co.*, 40 Wn.2d 614, 627, 245 P.2d 470 (1952). In *Evans* the insurer committed bad faith by unreasonably failing to settle the underlying claim against the insured within the policy limits. Since then, the Court has applied this remedy many times in third party liability bad faith claims. *See* Response Br., pp. 28-36.

For the estoppel remedy to apply, one of the following scenarios must exist: (1) the insurer fails to carry its burden of proof to show that

the insured was not harmed by the insurers' bad faith; (2) the insurer met its burden, but the insured successfully rebutted the insurer's evidence of no harm by submitting sufficient proof of harm. Thus, the estoppel remedy only applies if the element of harm has been satisfied. It does not, as Amici argues, apply to award damages where the element of harm has not been satisfied, or where no harm has resulted from the insurer's unreasonable bad faith conduct.

Washington's estoppel remedy applies to establish the measure of damages as the amount of the judgment entered against the insured following the insured's bad faith conduct. *Evans*, 40 Wn.2d at 627. As with the rebuttable presumption of harm, this Court applies the estoppel remedy because it provides a strong incentive for insurers to prevent their own bad faith conduct. *Butler*, 118 Wn.2d at 394 ("An estoppel remedy, however, gives the insurer a strong disincentive to act in bad faith"); *Kirk*, 134 Wn.2d at 564 ("The coverage by estoppel remedy creates a strong incentive for the insurer to act in good faith, and protects the insured against the insurer's bad faith conduct"); *Besel,* 146 Wn.2d at 739

("Because Viking acted in bad faith, Viking is liable for the entire amount of the settlement.")[12]

Amici's challenge that the estoppel remedy is a windfall for the insured misses the point. First, there must be a showing of some harm. Second, in *every* bad faith case in which this Court has applied the estoppel remedy, there was *no* coverage under the policy. This Court rejected this same "windfall" argument in *Butler*, where the insured argued that the Court could not use the estoppel remedy to extend coverage where none existed under the contract. 118 Wn.2d at 393. The estoppel remedy, however, does not technically extend coverage where it did not exist. Instead, the estoppel remedy provides a *measure* of extra-contractual damages resulting from the *tort* of bad faith even where there is no coverage. *Besel*, 146 Wn.2d at 738.

Amici is similarly mistaken in challenging the estoppel remedy on the ground that it is unfairly punitive. This Court addressed and answered the issue of proportionality just four months ago in *Paulson*, 161 Wn.2d at 922-3. There, the insurer failed to rebut the presumption of harm even though the insurers' bad faith did not cause monetary harm. Instead, this

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[12] *Hamilton v. State Farm Ins. Co.*, 83 Wn.2d 787, 791, 523 P.2d 193 (1974); *Transamerica Ins. Group v. Cubb & Son, Inc.*, 16 Wn. App. 247, 554 P.2d 1080 (1976), *rev. denied*, 88 Wn.2d 1015 (1977).

Court found harm in the form of "significant uncertainty" and "increased risk" for the insured's defense in the underlying action to be sufficient proof of harm caused by the insured's bad faith conduct. Even without quantifiable harm, this Court correctly applied the estoppel remedy to determine the measure of damages and held the insurer liable for the full amount of the stipulated judgment. *Id.* By doing so, this Court signaled that it will not reverse its long-standing reliance on the estoppel remedy in third party bad faith cases where the resulting measure of damages appears disproportionate to the harm actually suffered. *Id.*

This Court also rejected the proportionality argument in *Truck Insurance Exchange v. Vanport Homes, Inc.*, 147 Wn.2d 751, 764, 58 P.3d 276 (2002), stating that by committing bad faith, the insurer "voluntarily forfeited its ability to protect itself against an unfavorable settlement." The Court echoed the same position in *Besel*, 146 Wn.2d at 740, finding the insured liable for the entire covenant judgment because "[b]y choosing to act in bad faith, Viking accepted that it would injure its insured and be held responsible for that injury."[13]

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[13] In *Besel,* 147 Wn.2d at 765, the insurer issued a $25,000 liability policy. Following the insurer's denial of coverage, the insured settled with the underlying plaintiff with a stipulated judgment for $175,000 and a covenant not to execute against the insured. This Court applied the estoppel remedy to hold the insurer liable for the full $175,000 stipulated judgment.

RMS respectfully requests that the Court apply the estoppel remedy here to hold St. Paul liable for the full amount of the covenant judgment entered against St. Paul's insured once the element of harm in satisfied. The estoppel remedy provides a strong incentive for insurers to avoid bad faith conduct, which includes the failure to handle claims in a reasonable manner. This Court should not retreat from its long-standing policy of applying the estoppel remedy upon proof of bad faith conduct and satisfaction of the element of harm under the rebuttable presumption of harm.

D. Conclusion

Based on the foregoing, this Court should reject the arguments proffered by Amici. Amici has failed to raise any arguments that have not been considered and rejected by this Court many times in the past. RMS respectfully requests that this Court answer the Certified Questions in this case to confirm that Washington insureds may assert a common law claim for bad faith against their insurer in third party liability cases in the absence of a finding of coverage. Further, RMS quests that this Court confirm that the rebuttable presumption of harm applies upon proof of bad faith claims handling to shift the burden of proof on the element of harm to the insurer. Finally, RMS requests that the Court hold that the estoppel

remedy applies to set the measure of damages as the amount of the covenant judgment entered against the insured.

Respectfully submitted this 19th day of February, 2008.

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I hereby certify that on this 19th day of February, 2008, I filed the foregoing with the Clerk of the Circuit Court of Appeals Division I in Seattle and served the following parties in the manners indicated:

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